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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

RESPONSES OF SOUTHWESTERN BELL TELEPHONE COMPANY TO THE QUESTIONS POSED BY THE JOINT BOARD

ROBERT M. LYNCH
DURWARD D. DUPRE
MICHAEL J. ZPEVAK
DARRYL W. HOWARD

Attorneys for
SOUTHWESTERN BELL TELEPHONE COMPANY

One Bell Center, Suite 3524
St. Louis, Missouri 63101
(314) 235-2513

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SUMMARY*

Definitions Issues

While current local exchange rates are not unaffordable, affordability is best measured by identifying customers' ability to bear the cost of providing service. The implicit support mechanisms in LEC rates need to be eliminated by rate rebalancing to ensure customers pay more of the costs of their service. Subscription levels alone are not a good gauge of determining affordability. Instead, universal service expenditures should be seen as a household expenditure and measured as a percentage of median income. Based upon comparisons with other household expenditures, SWBT submits that 1.0% of a State's median income represents a reasonable level of expenditures for universal service. Although some allowance may need to be made initially, denying universal service support to carriers that do not provide all services within the definition of universal service is required by the Act and does not harm competition inasmuch as each new entrant determines when, where, and how it will provide service. There are many costs not included within the typical understanding of loop costs that are incurred in order to provide local exchange service.

Schools, Libraries, Health Care Providers

If a "funds to schools and libraries" approach is used, then the discount could effectively apply to all telecommunications services, as well as provide schools and libraries with greater flexibility. If a discount approach is used, the services should need to be limited due to the regulatory difficulties encountered with such an approach. The use of "telecommunications service" throughout Section 254(h) excludes inside wire or other connections on the customer's side of the network demarcation from funding under the Act. As a policy matter, including such wiring would not be competitively neutral even under a "funds to schools and libraries" approach. The Joint Board should employ Sections 706 and 708 to create the right environment for schools and libraries to encourage regulatory reform that will make advanced services more attractive. In order to promote increased competition for the telecommunications business of schools and libraries while minimizing regulatory involvement, a "funds to schools and libraries" approach should be adopted. However, the Act is clear that libraries, schools, and health care providers cannot resale services made available under Section 254. Moreover, if allowed, there is simply no effective way to attribute network usage to different entities. Using block grants to the States seems to place an unnecessary step into the "funds to schools and libraries" approach that will only work to the contrary goals of the Act. An electronic account system could alleviate accountability concerns regarding the use of universal service funding for schools and libraries. To ensure bona fide requests for Section 254(h) funding, States should prepare lists of qualified schools for the fund administrator, who could use a simplified form to verify the existence of a technology plan and provide information regarding progress in meeting the Act's goals. Adoption of a "funds to schools and libraries" approach would eliminate the difficult and unanswerable questions regarding benchmark pricing and costing. Schools and libraries would be free to purchase services in a competitive marketplace that would find them to be attractive customers. Issues on how to provide further discounts in those States that already make discounts available would disappear with adoption of a "funds to schools and libraries" approach. SWBT is also supplying an attachment with those educational and health care plans adopted by States in its

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* The abbreviations used in this Summary are as defined in the main text.

region. SWBT supports providing additional assistance to economically disadvantaged schools and libraries and those which face high telecommunications costs. Given funding limitations, however, the need should not be presumed. Existing programs directed at need could be used, and many factors (e.g., numbers of school buildings, students, economically disadvantaged students) could be taken into account. A separate funds should be established although funded with a single surcharge on interstate retail revenues. The McKinsey Report would be a reasonable basis on which to size the fund. For private schools, extrapolating from existing studies on public schools may be the best method of estimating private school costs.

High Cost Fund

General Questions: The current USF meets the principles of the Act and, with the exception of Tier 1 LEC funding, is properly targeted and sized. However, the method of funding USF and LTS should be modified to be consistent with the Act. The use of study areas should also be modified, with steps being taken to ensure that as an incumbent LEC that receives funding enters the service areas of another LEC, then USF funding is not extended to that new area. Actual costs should be used for determining universal service support, with new entrants demonstrating a need for support, capped at the level provided to the incumbent LEC. The Act makes no distinction between price cap LECs, non-rural LECs and other LECs, and any distinction under Section 254 would be contrary to the law, unreasonable, arbitrary, capricious, an abuse of discretion, and violates the substantive due process and/or equal protection rights of price cap and/or non-rural LECs. Neither a proxy cost model or competitive bidding are appropriate, and should not be mandated as either a transition method or final solution.

Proxy Models: As SWBT has consistently demonstrated, the currently proposed proxy cost models do not accurately reflect the actual costs of providing universal service, and thus should be rejected by the Joint Board and the Commission. The proposed models have been modified with no significant increase in accuracy, and call into question their validity and credibility. The reasons given adopting proxy cost models are unsubstantiated and contradict findings made over years of regulatory proceedings. The costs calculated by a proxy model should reflect the definition of universal service and, to date, none explain how that is attempted in the models. Any proxy model would need to be modified as both the universal service definition and technology changes; the use of actual costs eliminates the issue of technology changes. Inasmuch as a proxy cannot predict the costs that now exist to provide universal service, proxies should not be used for advanced services and information services. Actual costs for all areas and all carriers should be permitted. The currently proposed proxies provide no incentive for future infrastructure development. Any proxy model adopted for use with universal service funding must be made public.

Competitive Bidding: Competitive bidding is inappropriate as it would invite manipulation by competitors, discourage competition in high-cost areas and construction of facilities, and would add additional regulatory burdens; if adopted, all winning bidders must be willing to be bound by all of the carrier of last resort and other obligations as the incumbent LEC.

Benchmark Cost Model: SWBT is supplying a previous ex parte to demonstrate the difference between the actual cost of providing local service, and the output of the BCM. Using existing wire center data would be advantageous since it already exists. New entrants would not be disadvantaged since resale is an option to serve any part of a universal service area where their

own facilities do not exist. The use of a proxy would require changes to the USF rules and the interstate allocation limit rules.

Cost Proxy Model Proposed by Pacific Telesis: SWBT is not sufficiently familiar with CPM, but intends on supplying input after its analysis of CPM is complete.

SLC/CCLC

The interstate CCL recovers costs properly borne by the end user, but today for SWBT recovers $314 million annually from toll users ultimately. Of that, $36 million annually represents recovery of LTS. The net amount that SWBT retains is used to recover common line costs on an averaged basis. As demonstrated by SWBT, those revenues are largely generated in the low-cost metropolitan areas, but recover costs incurred in high-cost areas. SWBT recommends recovering the common line costs on a flat-rate basis, including phased-in increases to the interstate EUCL and recovering any remaining common line costs from the new universal service fund. If this approach is not used, then other alternatives would be necessary, including bulk billing, and flat-rating and deaveraging CCL charges. Under any circumstances LTS should be removed from the contributing LECs' CCL charges.

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RESPONSES OF SOUTHWESTERN BELL TELEPHONE COMPANY TO THE QUESTIONS POSED BY THE JOINT BOARD

Southwestern Bell Telephone Company (SWBT) files these responses to the questions posed by the Joint Board in this proceeding, which were set forth in the Public Notice, DA 96-1078, released July 3, 1996, by the Common Carrier Bureau.

SWBT believes that it is most practical for this proceeding to address universal service issues only as they pertain to the federal jurisdiction. Similarly, SWBT believes that the individual States should be allowed to independently develop solutions for universal service as they pertain to the individual State's jurisdictions. Therefore, SWBT's plan for universal service, and its responses to the questions contained herein, assume the separate and distinct development of federal and individual State universal service plans, each of which is consistent with the Telecommunications Act of 1996 (Act). Further, SWBT assumes these individual plans will be developed consistent with current jurisdictional cost and revenue delineations.

DEFINITIONS ISSUES

1. Is it appropriate to assume that current rates for services included within the definition of universal service are affordable, despite variations among companies and service areas?

Today's current subscribership level of 94% confirms that the current rates for services

included within the definition of universal service are not unaffordable for the vast majority of households. Affordability, however, refers to the customer's ability to bear cost, and that ability should be identified in order to determine affordable rate levels. Various implicit and explicit support mechanisms have allowed incumbent local exchange carriers (LECs) to extend below-cost prices to residential customers, regardless of the individual customer's ability to bear the cost of the service provided. SWBT believes that rebalancing of support through moderate increases in the end user common line (EUCL) charge and commensurate reductions in interstate common carrier line (CCL) charges, in conjunction with expanded Lifeline support and an appropriate level of explicit federal universal service support, will maintain subscribership and affordable rates.

2. To what extent should non-rate factors, such as subscribership level, telephone expenditures as a percentage of income, cost of living, or local calling area size be considered in determining the affordability and reasonable comparability of rates?

Although subscribership levels can be used as a threshold question to determine that rates are affordable for those subscribing to service, it is not a good gauge for determining affordability. Subscribership can be influenced by factors other than a customer's ability to pay.

The prices customers pay for universal service should instead be viewed as a household expenditure and, expressed as a percentage of income, be compared with other types of household expenditures to determine affordability. Telecommunications expenditures expressed as a percentage of income provides a basis for determining affordability in comparison with other household expenditures. The average household total telecommunication expenditures currently account for 2.0-2.5% of median income. Basic local exchange expenditures currently account for

0.7% of median income. SWBT suggests 1.0% of State median income is a reasonable and affordable level for universal service expenditures.

3. When making the "affordability" determination required by Section 254(i) of the Act, what are the advantages and disadvantages of using a specific national benchmark rate for core services in a proxy model?

The use of a federal benchmark rate provides a reasonable measure to identify the level above which costs would qualify for high-cost support only to the degree the proxy cost model accurately reflects the actual interstate costs incurred in providing universal service to customers in high-cost areas. If the proxy misstates the actual costs required to be incurred to serve customers in high-cost areas, the resulting support will not be appropriate to maintain universal service in those areas, comparable to that provided in low-cost areas.

4. What are the effects on competition if a carrier is denied universal service support because it is technically infeasible for that carrier to provide one or more of the core services?

Only those carriers willing and able to support the definition of universal service should be funded through a national program. Congress recognized this important principle when it emphatically limited universal service funding to "eligible telecommunications carriers" (47 U.S.C. 254(e)), which are required to "offer the services supported by the Federal universal service support mechanisms." 47 U.S.C. 214(e)(1)(A). Funding a carrier that does not meet that requirement would be contrary to the language of the statute and the clearly expressed intent of Congress.

There is no harm to competition caused by this type of funding. A carrier that chooses to expend the capital necessary to meet qualification and eligibility criteria will receive support on a

competitively neutral basis. Those carriers who choose not to expend the necessary capital to meet that criteria may still seek customers in selected markets, but would not receive support for the limited services that it has chosen to provide.

Application of the guidelines in Section 254(c) for defining universal service should result in very few areas that lack a carrier that is technically incapable of providing all the services comprising universal service. Upon defining the services comprising universal service, a reasonable grace period should be established to allow carriers to meet the universal service definition.

5. A number of commenters proposed various services to be included on the list of supported services, including access to directory assistance, emergency assistance, and advanced services. Although the delivery of these services may require a local loop, do loop costs accurately represent the actual cost of providing core services? To the extent that loop costs do not fully represent the costs associated with including a service in the definition of core services, identify and quantify other costs to be considered.

Loop costs, the cost of the cable and wire facilities and the central office subscriber circuit equipment necessary to provide the physical connection between the customer premises and the initial central office, represent the largest share of the costs necessary to provide universal access for core basic services. However, other costs are also essential to providing such universal access. These costs include that portion of the local dial switching equipment necessary to make the connection usable. This would include the portion of the local dial switch which connects the customer to the switch, as well as the traffic-sensitive portion of the switch to connect calls from the customer to other customers. Also, if the core services include a calling scope that encompasses other central office locations, additional switching costs should be included as well

as interoffice transmission equipment in the central offices and the interoffice cable and wire facilities.

LECs also incur substantial expenses in addition to the costs described above to make core services available. For example, customer service operations are necessary to allow customers to request service, change service, obtain assistance, and discontinue service. Providing operator services requires substantial costs for facilities and providing customer assistance. Advanced services also require LECs to incur non-loop related costs (e.g., ISDN requires special switching equipment). Moreover, expenses result from the administration and support of SWBT's network and the provision of services over it. These typically include costs associated with land and buildings, motor vehicles, furniture, computers and office equipment.

By way of example, the following Table identifies the amount and types of costs for SWBT's Texas operations that are necessary for SWBT to provide local exchange services,

directory assistance, and access to operator services.

SWBT - Texas, 1995
Cost of Local Exchange Switched Network

Cost Category	Amount ($M)	Percent
Facility-Related Costs[1]		
Loop	$1,586M	42.0%
Switching	$497M	13.0%
Trunk	$139M	4.0%
Operator	$15M	0.5%
IOT	$132M	3.5%
Subtotal	$2,369M	63.0%
Services Expense		
Customer Services	$274M	7.0%
Operator Services	$106M	3.0%
Subtotal	$380M	10.0%
Support Costs		
Support Facilities[1]	$221M	6.0%
Support Expenses	$203M	5.0%
Corporate Expenses	$332M	9.0%
Marketing Expenses	$68M	2.0%
Other Support Costs	$202M	5.0%
Subtotal	$1,026M	27.0%
Total Costs	$3,775M	100%

All of the above costs should be considered in determining the amounts associated with universal services.

Various definitions of loop costs also currently exist. The Joint Board and the Commission should be aware of certain shortcomings in using these costs for evaluation of costs

[1] Includes authorized interstate return and income taxes on net investment, maintenance, depreciation, and network operations expenses.

related to core services. The 47 C.F.R. Part 69 rules calls for the inclusion of interstate loop costs in the Common Line element. Common Line costs are often interpreted as loop costs for evaluating or setting interstate access rates, even though these only represent the interstate portion of costs (25% of loop costs are assigned to interstate by the separations process). In addition to costs associated with the loop, the Common Line element includes costs of Information Origination/Termination (IOT) equipment. IOT costs include costs associated with pay telephone sets and PBX equipment. If core services were defined as residence only, most of those IOT-related costs should be excluded.

On the other hand, costs assigned to the Common Line element exclude costs related to providing customer services. For instance, a substantial portion of customer service expenses and operator services expenses are not assigned to the Common Line element, but are necessary for providing core services. The majority of such costs have typically been assigned to the intrastate jurisdiction by the separations process. Another commonly used version of loop costs are the total (unseparated) loop costs that are calculated for the interstate Universal Service Fund (USF). The calculation of these costs exclude essential categories of costs related to providing core services, including customer service costs, operator service costs, and costs associated with general support facilities.

Loop costs have also been calculated by cost proxy models such as the Benchmark Cost Model and the Hatfield Model. See Attachment 1, "Which Cost is Right?" These models employ long-run incremental costing methods. The comparisons of the results of these models with

SWBT's actual cost data has shown that these models do not reasonably estimate actual facility costs and operating costs associated with providing core services. Most incremental cost methods, by design, do not depict all of the cost of operations and providing universal service. Use of incremental costs for estimating costs of providing core services may substantially understate the actual costs necessary for universal service.

SCHOOLS. LIBRARIES, HEALTH CARE PROVIDERS

6. Should the services or functionalities eligible for discounts be specifically limited and identified, or should the discount apply to all available services?

If the proper mechanism is established, such as a "funds to schools and libraries" approach as described in SWBT's response to Question No. 9 below, then the range of available services for schools and libraries should be sufficiently broad to include all available telecommunications services. This provides schools and libraries with the most flexibility to choose the services and functionalities which best serves their needs. However, if a pricing discount plan is implemented, the list of services will need to be limited because of the regulatory difficulties created by such an approach. Some of these problems are described in further detail below, particularly in response to Question No. 16. In any event, the federal universal service plan should complement the initiatives already taken or that may be taken by the States. The federal effort should not interfere with the progress already made or anticipated by the States.

7. Does Section 254(h) contemplate that inside wiring or other internal connections to classrooms may be eligible for universal service support of telecommunications services provided to schools and libraries? If so, what is the estimated cost of the inside wiring and other internal connections?

Section 254 does not contemplate that inside wiring or other internal connections to classrooms be eligible for universal service support. Section 254(h)(1)(B) limits the scope of support for educational providers and libraries when it makes available, at a discount, only those "services that are within the definition of universal service under subsection (c)(3)." Section 254(c)(3) permits the Commission to designate "additional services" to support for educational providers "in addition to the services included in the definition of universal service" under Section 254(c)(1). Section 254(c)(1) in turn, is expressly limited to "telecommunications services." Through each of these subsections of Section 254, "services" and "telecommunications services" are used interchangeably, with reference to each other, and are clearly synonyms. The phrase "telecommunications service" is based on "telecommunications," which means "the transmission . . . of information." In sum, there is no basis for concluding that wiring beyond any carrier's telecommunication network is a "telecommunications service" or otherwise falls within the support mechanisms to be established under Section 254.

Beyond the obvious definitional problems with the inclusion of inside wiring, it would not be competitively neutral to do so. Since the Act is clear that only telecommunications carriers are eligible to receive universal service funding, the multitude of providers who specialize in inside wiring and internal connections (e.g., electricians, LAN providers) would be at a competitive disadvantage since they would be ineligible to participate in a universal service fund under Section 254.

Any attempt to include inside wire providers as participants in this process would simply

not be practical. It would be logistically difficult to attempt to identify all the electricians and other providers who offer inside wiring and to seek payments from them into the universal service fund. Even more problematic would be the apparent necessity to deem electricians and other inside wire providers as telecommunications carriers, which raises numerous regulatory and legal implications at both the federal and state level. SWBT does not believe Congress intended that the Commission extend its authority beyond traditional telecommunications services in this fashion.

8. To what extent should the provisions of Sections 706 and 708 be considered by the Joint Board and be relied upon to provide advanced services to schools, libraries and health care providers?

Sections 706 and 708 provide the ability to create an environment for a more rapid deployment of advanced services, particularly to schools, libraries and rural health care providers. To the extent the Commission and the States eliminate restrictive and outdated regulations which inhibit the attractiveness of the local telecommunications market, then additional infrastructure deployment capable of providing advanced telecommunications and information services is likely to occur. A LEC's ability to effectively compete without burdensome regulations will affect its investment in the infrastructure and its ability and willingness to achieve public policy goals such as connecting schools and libraries to the information superhighway.

9. How can universal service support for schools, libraries, and health care providers be structured to promote competition?

SWBT believes this issue to be an important consideration in deciding how this provision of the Act should be implemented. The Joint Board and the Commission have the opportunity to

design a solution that will promote competition and establish the education market as an attractive market sought after by all competitive telecommunications service providers. Alternatively, the solution, if structured improperly, will have the opposite effect -- one where selling services to the education market is not attractive and is subject to extensive regulatory burden. Such a solution will not achieve the results desired by Congress.

To avoid such an outcome, SWBT believes a "funds to schools and libraries" approach will achieve the goal of promoting competition and making the education market an attractive market. The "funds to schools and libraries" mechanism would provide funds directly to schools and libraries for their use in purchasing telecommunications services. Such an approach provides schools with the maximum flexibility while avoiding the need for extensive federal regulatory actions. The "funds to schools and libraries" approach solves many of the problems identified by the questions posed in the Public Notice and, if structured properly, will provide the optimum method for implementing this provision of the Act.

For rural health care providers, the proposal offered by the United States Telephone Association (USTA) appears to be the most reasonable approach for accomplishing the goals of the Act. USTA suggests that services be sold to rural health care providers at statewide-averaged prices. This will extend to those providers the benefits of lower prices realized in competitive markets.

10. Should the resale prohibition in Section 254(h)(3) be construed to prohibit only the resale of services to the public for profit, and should it be construed so as to permit end user cost based fees for services? Would construction in this manner facilitate community networks and/or aggregation of purchasing power?

The provision of the Act is clear. These public institutions cannot offer these telecommunication services for resale. It was not Congress' intent to pass the benefits of these special provisions on to other entities and to put these public institutions in competition with telecommunications carriers.

11. If the answer to the first question in number 10 is "yes," should the discounts be available only for the traffic or network usage attributable to the educational entities that qualify for the Section 254 discounts?

Even if these public institutions were allowed to offer these service on a resold basis, SWBT does not know how the network usage attributable to different parties could as a practical matter be separated.

12. Should discounts be directed to the states in the form of block grants?

While SWBT believes that funds should be allocated to schools and libraries rather than implementing a pure price discount plan at the federal level, SWBT does not believe that allocating funds to the States is appropriate. SWBT recommends that the federal plan provide for direct allocation methods where funds can be allocated directly to schools and libraries without having to pass through State organizations. This would minimize costs, increase timeliness, and ensure maximum use of the collected funds.

13. Should discounts for schools, libraries, and health care providers take the form of direct billing credits for telecommunications services provided to eligible institutions?

With a "funds to schools and libraries" approach, a credit mechanism could be used as the method of managing the funds. Schools and libraries could use credits to purchase telecommunications services and the service provider could seek reimbursement for the credits

from the universal service fund. However, if a pricing discount plan is implemented, a billing credit approach could be examined as a more appropriate method than the regulatory intensive effort required to change every tariff price in every jurisdiction for every service included within the definition of universal service for education providers and libraries.

14. If the discounts are disbursed as block grants to states or as direct billing credits for schools, libraries, and health care providers, what, if any, measures should be implemented to assure that the funds allocated for discounts are used for their intended purposes?

There will need to be some simple measures to ensure that funds are being spent appropriately. If an electronic account system were created which restricted fund reimbursement to the offering of the specified telecommunications services as described in SWBT's response to Question No. 6, many of the accountability concerns could be alleviated.

15. What is the least administratively burdensome requirement that could be used to ensure that requests for supported telecommunications services are bona fide requests within the intent of section 254(h)?

SWBT recommends the use of a simplified process. States already know what schools exist within their borders, so each State could provide a list of qualified schools to the fund administrator. Before a qualified school receives its distribution, it could complete a simple form providing check off boxes to verify the existence of a technology plan and provide answers to a few simple questions which are required to demonstrate progress in meeting the Act's goals.

16. What should be the base service prices to which discounts for schools and libraries are applied: (a) total service long-run incremental cost; (b) short-run incremental costs; (c) best commercially-available rate; (d) tariffed rate; (e) rate established through a competitively-bid contract in which schools and libraries participate; (f) lowest of some group of the above; or (g)some other benchmark? How could the best commercially-available rate be ascertained, in light of the fact that many such rates may be established pursuant to confidential contractual

arrangements?

If the "funds to schools and libraries" approach is used, a base service price is not necessary. Carriers would compete to provide telecommunications services to schools and libraries, especially since they know that schools and libraries have been given these funds to be used to purchase services. The competitive market will establish pricing levels.

The alternative is to have regulators struggle to establish base service prices for which discounts would apply. For a federal plan, this approach is very problematic. Given that there are many State plans already in existence, the Commission should not impose a specific plan on the States. States should continue to have the flexibility to create plans as they deem appropriate and in the public interest. Imposing specific methods on the States for determining base service prices is inappropriate. Some States may not want a cost-based approach because an incremental costing approach applicable to all telecommunications carriers would likely require extensive regulatory proceedings to determine the costs for every service identified as a special service. While this approach would be incredibly difficult for incumbent LECs, it would be even more problematic for all of the new LECs, interexchange carriers (IXCs), and other carriers entering the telecommunications markets. If an incremental cost approach were implemented, every new telecommunications carrier in every market it serviced should be required to produce cost studies for all of its services since every carrier, even those not deemed eligible telecommunications carriers, are subject to the discount provisions of the Act. For example, if long distance services were included, interexchange carriers would have to produce incremental cost studies for those